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BRIEF
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Georgia: Attracting investments, contributing to economic growth

In September 2005, the Millennium Challenge Corporation (MCC) signed a five-year, $295.3 million compact with the Government of Georgia to address two main barriers to economic growth: lack of reliable infrastructure and slow development of businesses, particularly agribusiness.

After extensive analysis, the Government of Georgia and MCC agreed that lifting these barriers through a program of complementary investments focused on the regions outside the capital, Tbilisi, would help unlock the entire country's economic growth potential. When MCC declared Georgia eligible to develop an MCC Compact proposal in 2004, a new Georgian government had just begun to rebuild the country.

In the immediate aftermath of Georgia's non-violent "Rose Revolution" in November 2003, the Government of Georgia undertook a wide array of reforms and initiatives aiming to bring stability, transparency, and shared economic prosperity to the nation.

The country's economy contracted dramatically after the collapse of the Soviet Union and Georgia's civil war of the 1990s, shrinking more than any other former Soviet Republic. To date, the economy has still not recovered to pre-independence levels. According to Georgia's Department of Statistics, over half the working-age population engaged in agriculture as their primary form of employment.

After privatization of collective farms in the 1990s, Georgia became a country of small private land holdings with plots averaging less than one hectare, primarily supporting subsistence growing. Both farmers and agribusinesses were struggling to compete in global markets. Infrastructure to bring goods to market and facilitate trade and economic growth had crumbled. Persistent budget shortfalls, corruption, scrap-metal looting, and technical brain drain took a steep toll on Georgia's road, water, energy and railroad infrastructure entities.

In this setting, the Millennium Challenge Compact targeted what the Georgians believed was crucial to helping Georgia rebound: (1) rehabilitating basic infrastructure to support growth and trade and (2) helping the agricultural sector of the economy modernize and transform by accelerating private investment. The compact projects focused on rehabilitating regional infrastructure and enterprise development to improve the lives of the poor by helping them integrate economically through improved access to jobs and markets, more reliable access to basic services, and provision of capital for enterprise development.

In November 2008, MCC increased the funds available through the Georgia Compact to $395.3 million, which allowed for completion of works otherwise subject to budget shortfalls in the Rural Infrastructure Rehabilitation Project as contemplated by the original compact.

MCC will be conducting independent impact evaluations to measure improvements attributable directly to these investments, controlling for overall changes and improvements in the Georgian economy and changes that might have occurred regardless of MCC's interventions. MCC expects that the results of its



From left to right, the Samtskhe-Javakheti Road before rehabilitation, during construction and once completed.

impact evaluations not only will serve an accountability function, but also help guide future investment decisions and contribute to a broader understanding in the field of development effectiveness.

Yet, even before income gains are fully captured, MCC and Georgia have important achievements and monitoring results to report. For example:

- ★ 220 kilometers of road have been rehabilitated, connecting the capital of Tbilisi to an under-served agricultural corridor in the country's southwest, as well as Armenia and Turkey. This rehabilitation reduced travel time from more than eight hours to under three hours, resulting in an estimated savings in costs to vehicle operators of more than $13 million in 2011. The road also improves the link between Georgia and Armenia and opens a new route to Turkey, creating a key corridor for international trade and investment.
- ★ More than 3,400 jobs have been created with an accompanying wage increase of almost $1.7 million. Investments increased firm income by more than $3.8 million through an agribusiness development program that included investments across the value chain, including projects aimed at modernizing dairy production, cold storage facilities, fruit drying equipment, greenhouses, nurseries, nut processing equipment, high-quality potato seeds, and fruit and vegetable processing equipment.
- ★ Critical repairs were made to Georgia's main trunk gas pipeline, which runs from the Russian border to Armenia, improving Georgia's energy security.

MCC Principles into Practice: Country ownership at work

When MCC was established in 2004, enabling country-led development was one of its three core principles to enhance both results and sustainability. MCC's approach to country ownership means that country partners take the lead in prioritizing investments, designing and implementing programs, and being held accountable for results.

The Center for Global Development singled out country ownership as one of the defining features of the Georgia Compact. MCC's work with the Georgian Oil and Gas Corporation repairing the main natural gas pipeline illustrates the many faces of country-led development in the Georgia Compact.



From left to right the gas pipeline repair before and after.

Deciding to hire the new, state-owned LLC Georgian Oil and Gas Corporation (GOGC) as project managers for the natural gas pipeline repairs—rather than an international management firm—was a calculated risk taken by MCC and the Government of Georgia in 2006.

To mitigate the risks associated with managing a complex construction program, and to help build management capacity gradually, the program divided into three phases. In Phase I in 2006 (essentially a pilot effort), MCC and the Government of Georgia sought technical support and additional donor funding from the energy company BP, the most technically adept firm in Georgia to assist with pipeline works, and the European Bank for Reconstruction and Development (EBRD) to fund some of the initial survey and design work. Phase I also relied heavily on an international team of experts committed to growing the domestic capacity to manage this type of major project.

GOGC grew to assume more responsibilities in Phases II and III of the repair works. Through the MCC capital investment and related on-the-job support, the company emerged stronger and capable to manage the pipeline to improved standards and sustain both the compact investment and the Georgian energy system. Over the course of the compact, GOGC developed into Georgia's premier energy company. Moreover, the new designs and standards employed are expected to reduce long-term maintenance costs.

The compact's Energy Rehabilitation Project also offered a growth opportunity for Georgian and regional construction companies. In 2006, no Georgian companies were qualified for large scale pipeline work. The technical skills and expertise gained from working to international standards set a new bar for engineering achievement in Georgia and strengthened local capacity to ensure the pipeline's sustainability over the long term.

The compact's investment of $36 million in repairs to the gas pipeline over four years, from 2006 to 2010, together with other Government of Georgia investments, have helped to secure and diversify Georgia's domestic gas supply for household and commercial use.

Regional Infrastructure Rehabilitation Project

This project aimed to rehabilitate key regional infrastructure by improving transportation for regional trade, increasing reliability of energy supply, and improving municipal services in the regions.

Samtskhe-Javakheti Road Rehabilitation Activity	Energy Rehabilitation Project	Regional Infrastructure Development Activity
Reconstruction of a poorly-maintained local road into a key national and regional route, linking the capital Tbilisi with an under-served agricultural corridor in the country's southwest as well as Armenia, and for the first time, Turkey. • Rehabilitated 220 kilometers of roads. • Reduced average travel time from 8 hours,13 minutes to 2 hours, 42 minutes. • Savings in vehicle operating costs are estimated to be more than $13 million in 2011.	Avoid costs associated with emergency pipeline repairs and increase Georgian energy security through rehabilitation of key sections of the main transshipment pipeline for natural gas between Russia and Armenia. • Rehabilitated and improved regional and municipal service delivery in 22 key sections of the main transshipment pipeline for natural gas between Russia and Armenia. • Increased energy reliability and security throughout the country, thus reducing the probability of catastrophic failure.	Reduce costs borne by the public and businesses to cope with intermittent, unreliable water supplies through rehabilitation and development of municipal water and wastewater infrastructure. • Planned construction works completed in four out of five cities and works to continue with additional donor funding. • Improved water supplies. • More than 67,000 people received improved water services from the activity.

More results to come

MCC applies a rigorous framework to monitor projects and measure the cost-effectiveness of our investments. This includes conducting rigorous, independent impact evaluations on over half of our investments—more than any other donor. To learn more about MCC's impact evaluations, please visit www.mcc.gov/impacteval. In Georgia, the roads impact evaluation combines an innovative geographic information system (GIS) model to measure the change in incomes and other indicators in communities along the road before and after the rehabilitation.

The GIS model calculates an "access index" for all communities near the road and provides a measure of relative proximity to and effects from the road versus more distant "control" communities. Communities are also matched using observable characteristics. The expected impact evaluation completion date is 2013; thus far, for the planned impact evaluation of the Regional Infrastructure Development Activity, only baseline data collection measuring a variety of indicators including business and residential coping costs has been completed. Post-activity data collection, and thus the evaluation completion date, is uncertain, as it depends on the completion of parallel activities funded by other donors that affect whether full benefits are to be expected among targeted beneficiaries.

Enterprise Development Project

This project aimed to increase profitable investments in small and medium sized enterprises and improve the economic performance of agribusinesses.

Agribusiness Development Activity	Georgia Regional Development Activity
Improve economic performance of agribusiness by providing matching grants and technical assistance to a wide range of agribusinesses. • IImproved the economic performance of 290 agribusiness and farm production projects. • Created 3,264 jobs (as of July 2011).. • Businesses report an increase in wages of almost $3.2 million and an increase in firm income of over $2.7 million.	Provide medium-term risk capital and technical assistance to small and medium-sized enterprises outside of the capital and primarily in the agribusiness and tourism sectors through an independently managed investment fund. • More than $16.8 million increase in gross revenues of companies in the portfolio. • Increase of 208 employees in portfolio companies (as of July 2011). • $1.7 million increase in wages paid to employees of portfolio companies.

More results to come

The impact evaluation for the Agriculture Development Activity will measure the impact of the activity on incomes and job creation among Primary Producers through an analysis of early and late treatments, determined through a partially randomized selection process for grantees from among qualified applications.

Farm Service Center and Value-Adding Enterprise grantees will be evaluated by matching grant recipients to similar enterprises based on observable characteristics. The expected impact evaluation completion date is 2013, although limited interim results from initial rounds may be available sooner.

This is a ten-year investment fund now in year five. When the fund has been divested, expected in 2014-2015, MCC will undertake an impact evaluation to examine the fund's contribution to economic growth and job creation in Georgia.

Insight into Implementation

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Insights on implementation in Georgia that have strengthened MCC's approach include:

MCC is an institution that learns from and makes decisions based on results. Certain activities, such as the Agribusiness Development Activity, were refined so that potential loan recipients received additional assistance with business proposal development. This led to an increase in the number of qualified applicants; after several rounds of loan solicitation, the program was expanded to respond to the overwhelming number of applications from interested rural entrepreneurs.

MCC course-corrected wherever possible, learning from implementation issues early on. Outcomes of our projects—even when they fall short of targets—are being evaluated as rigorously and transparently as possible to improve development practice and effectiveness. MCC and partner countries work together to identify and address implementation challenges, to keep current investments on track, and to inform the design and implementation of future MCC investments.

★ **MCG Rises to the Challenge:** Although successfully completed in year five, the Samtskhe-Javakheti Road project proved to be a defining challenge of the compact. The construction contractor, selected through transparent and competitive bidding, under-performed for over half the road, jeopardizing the ability of the implementing entity, Millennium Challenge Georgia (MCG), to deliver and make use of compact funding. Honoring the spirit of the contract, MCG tried to facilitate road completion by reducing the contractor's workload, but this too proved untenable. MCG terminated the contract and divided the work among the remaining contractors who then redoubled efforts in order to meet MCC's five year timeline. In the end, 220 kilometers of the Samtskhe-Javakehti road were repaired, connecting an economically and physically isolated region of Georgia to the capital and facilitating access to international trade with Armenia and Turkey.

★ **Investment Fund Slowly Rebuilds:** The $30 million Georgia Regional Development Fund (GRDF) has weathered several storms, notably the twin shocks of the August 2008 Russia-Georgia conflict and the global financial crisis. The program was designed to finance investments considered more risky than those made by Georgia's commercial banks. GRDF seeks to target companies that might not have access to in-country financing, and offers these companies marginally higher interest rates and accepts greater equity stakes. Some of the companies in the investment portfolio, however, are experiencing financial difficulties related to the current global economic climate.

Additionally, the aggressive job creation targets set at the onset of the compact have proved unrealistic for GRDF. A contributing factor to this disconnect is that the fund's directives are to invest primarily outside the capital city, and in the tourism and agribusiness sectors, but not specifically in sectors that are labor-intensive. The investment fund is designed as a 10-year fund; now, in year five, it is too early to draw firm conclusions on the fund's developmental impact. Still, successes are materializing. Income (re-flows) generated from GRDF's investments will finance potential educational exchanges with American students and faculty. Scholarships will be primarily in technical sectors, designed to build up capacity to maintain and expand upon MCC's work in Georgia.

★ **MCC Re-Examines Water Project:** The Regional Infrastructure Development (RID) was originally designed to be an infrastructure-financing facility, in which MCG grants would finance 35 percent of a public infrastructure investment project, between $0.5 and $7 million, up to a total of $60 million. RID's original design sought to encourage leveraged financing and an array of small and medium-sized infrastructure projects. However, the lead time to craft and finance these, as well as the transaction costs that accompany developing many small infrastructure projects, proved difficult to fit into MCC's five-year model. Sixteen months into the compact, MCC lifted the funding cap to allow for larger investments focused in the drinking water and irrigation sectors.

When MCG had expected to be a minority financier, it signed full oversight agreements to other donors active in the sector. While this donor coordination supervision is attractive in principle because it potentially streamlines requirements for the beneficiaries, in practice it led to confused responsibilities and less opportunity for MCC to engage in addressing weaknesses throughout the project cycle. MCC's infrastructure oversight model puts a premium on quality, and retrospectively the RID project may have been better served by the oversight models employed in the gas pipeline and Samtskhe-Javakheti road rehabilitation projects.

In addition to the overall RID design, the reconfigured RID faced challenges undertaking large municipal water projects in a sector that had been long neglected. Original expectations of what the RID budget could accomplish and the benefits it would yield were set too high and generally were downwardly scoped. In two of the five cities, engineering contractor, an international consortium, produced sub-standard designs requiring numerous revisions; ultimately the design for one of the communities was rejected.

Extra efforts were made to help assure that the works were completed through staffing changes and re-tendering works. Nonetheless, because of the completion of sub-projects near the end of the compact and ambiguity in terms of outcomes, further assessment is required to determine RID's outcomes. Also, because four of the sub-projects were co-financed with other donors, expected benefits of sub-project investments depend not only on the work done by the MCG contractors but also on when these other investments are completed after the compact end date.

MCC is committed to conducting independent impact evaluations of its programs as rigorously as possible as an integral part of its focus on results. MCC expects that the results of its impact evaluations will help guide future investment decisions and contribute to a broader understanding in the field of development effectiveness.

The Millennium Challenge Corporation is a learning institution, and is committed to transparently sharing implementation challenges and lessons learned, both to inform MCC's own future investments, and to foster learning in development more broadly.

Sustainability of Impacts

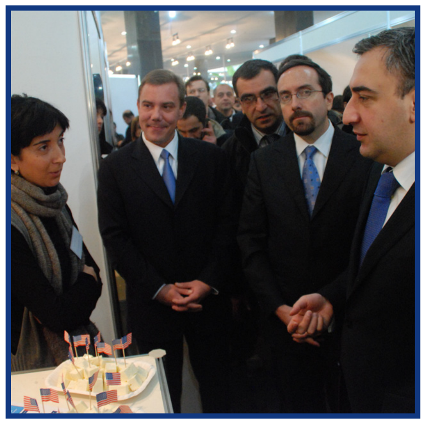
MCC's investments address fundamental barriers to growth and poverty reduction and were designed to generate significant new income for beneficiaries long after MCC compact programs end. Each of Georgia's five compact projects were undertaken to address fundamental barriers to growth and poverty reduction, and to generate significant new income for beneficiaries long after the compact has ended.

- ★ For the Samtskhe-Javakheti Road Project, the Government of Georgia chose to build a durable, modern asphalt road that would withstand the freeze and thaws at the 2,000 meter pass and the weight of the large trucks travelling to and from Georgia into Armenia and to the new border crossing in Turkey. To ensure sustainability, as a condition precedent for disbursement on the Samtskhe-Javakheti Road Activity, the Government of Georgia committed to annual increases in the state's road maintenance appropriations. Georgia fulfilled this commitment increasing from $33.6 million in 2006 to over $56 million in 2010.

- ★ MCG's experiences working with GOGC to repair pair the main natural gas pipeline also exemplifies how capacity building has increased the sustainability of MCG's efforts. By providing a well-supported, hands-on opportunity to oversee the design and implementation of all facets of pipeline rehabilitation, MCC capital investments have helped build a stronger domestic institution capable not only of maintaining the investment, but also one being selected to conduct similar work for others.

★ The Agribusiness Development Activity's (ADA) competitive grants reduced risk and also encouraged investment earlier than would have otherwise happened. ADA's grants leveraged over $15.7 million in private investment, introducing innovative technologies that will serve as models to peers and neighbors after the compact has ended. Capitalized investments have also better positioned ADA's agribusinesses to take out loans for future business expansion.

Compact re-allocations, re-scoping, and re-structuring



Left: Nino Zambakhidze gives MCC CEO Daniel Yohannes a tour of her dairy plant in October 2010

Middle: Nino Zambakhidze meets with Prime Minister Nika Gilauri and Ambassador John Bass at the ADA Expo in November 2010.

Bottom: A worker tours renovated Piunik plant in Georgia through $2 million in financing from MCG's Georgia Regional Development Investment Fund (GRDF).

Several months after the Russia-Georgia conflict, MCG received an additional $100 million in MCC funding, bringing the compact total to $395.3 million. This increase, as part of an overall United States Government effort to support Georgia, allowed MCG to complete the Samtskhe-Javakheti Road Project as originally envisaged, covering the additional costs resulting from the dramatic, global rise in oil and construction prices, as well as road engineering design changes. Additionally, MCG increased the grant financing to the RID project such that more neighborhoods received water and sewerage system improvements in four communities.

Success Story

Nino Zambakhidze is the owner of Georgian Business Zone (GBZ), a dairy processing plant and cattle-breeder food processing plant in Akhaltsikhe, South Georgia.

Set up in 2008, the company employs 45 locals and 300 beneficiary farmers and produces two types of cheese and cream. In 2009, GBZ received a grant worth $122,905 under Millennium Challenge Georgia

Fund's Agribusiness Development Activity (ADA). According to Nino, "We sell [our product] in Tbilisi's supermarkets and plan to expand our sales in the near future."

Today, the plant collects approximately four tons of milk and produces 350-400 kg of cheese daily during the high season (April-October). The milk is collected from local farmers. This past June, the plant collected 75 tons of milk. The company's annual profit is approximately $260,000.

In the 1980s Georgia had a sizeable poultry breeding industry; however, this collapsed after independence. Since then, poultry businesses including Piunik, relied on imports for hatching eggs and one-day old chicks to distribute and/or raise for domestic production. With $2 million in financing from MCG's Georgia Regional Development Investment Fund (GRDF) in 2008, Piunik was able to renovate their poultry business and purchase modern equipment for domestic egg production. Piunik has already captured 50 percent of the domestic incubated-egg market and is aiming to capture 70 percent by the end of 2011. Import substitution is great for the Georgian economy and MCC is pleased to support this first-mover in the industry.

The Ministry of Economy and Sustainable Development created the first-ever Mercury Awards to showcase new successful businesses and innovations in Georgia. The award-jury selected Piunik from among 300 participants.